Preparing for the new revenue standard
Are you ready?

A call to action

• The 2018 effective date for the new revenue standard may seem far away, but businesses can’t change systems, processes, and controls overnight. Therefore, the implementation effort should not be underestimated.

• While some companies have begun their analysis, others continue to delay their implementation, perhaps because of proposed clarifications to the standard or in hopes of further deferral. Still others have completed a high-level assessment, but have not taken the next step.

• Understanding the big picture is a good starting point, but many issues won’t become evident until companies get into the details of how the guidance will apply to their transactions. They will need adequate time to understand the implications, and to consider whether they want to make changes to their contractual arrangements or business strategies as a result.

• A successful implementation requires thorough planning. The first step is assessing the accounting and disclosure requirements for all revenue transactions under the new guidance. Based on these conclusions, companies will need to identify, design, and implement any necessary changes to their systems, processes, and controls. The final phase is testing any new or modified controls to help avoid surprises in the year of adoption. While every company is different, each of these phases could take several months or longer. As such, companies should plan appropriately.
The path forward

Revenue is considered one of the most important financial statement metrics as it provides insights into a company’s past and potential future performance and financial health. Today there are multiple revenue accounting models and various sources of industry-specific guidance. This can result in different accounting for economically similar transactions. As such, the FASB (along with the IASB) developed a new principles-based standard that will be applicable across industries and around the globe. The standard replaces industry-specific guidance and removes inconsistencies in current guidance thereby enhancing comparability.

When originally issued, the standard would have been effective for most US public companies in 2017. However, the effective date has been delayed by a year such that it is now applicable starting in 2018.

Why the deferral?
The FASB and IASB decided to delay the effective date by one year to allow adequate time for companies to effectively implement the new standard. In doing so, they acknowledged that the original standard was issued almost a year later than anticipated. And, even after it was issued, the boards continued to deliberate certain key aspects of the standard, such as accounting for licenses of intellectual property and identifying performance obligations.

Getting started now
The good news is that deliberations on fundamental issues are beginning to wind down, and many of the more significant issues have now been discussed. Any remaining changes are expected to be less significant in nature. As such, now is the time for companies to move forward.

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...the level of effort required to ensure all transaction types are appropriately analyzed is significant, and the time necessary to achieve a successful implementation should not be underestimated.

James Schnurr, SEC Chief Accountant, September 17, 2015

Selecting a transition method
When adopting the new revenue standard, companies can select from two transition alternatives: a full retrospective method or a modified retrospective method.

The full retrospective method requires companies to recast prior-period financial statements as if the guidance had always existed. For example, a calendar year-end public company would recast its 2016 and 2017 financial statements in its 2018 annual financial statements. While this transition method could be more demanding from a recordkeeping perspective, it would result in greater comparability and would likely be preferred by the analyst and investor community.

The modified retrospective method provides companies with some relief as prior year financial statements would not need to be recast. Instead, companies would recognize the cumulative effect of initially applying the standard as an adjustment to opening retained earnings. Disclosures reflecting the results under legacy GAAP would also be required for the initial year of adoption, which would effectively require dual recordkeeping for that year.

Regardless of the transition method selected, in order to effectively chart their course, companies will have to create a project plan that includes key milestones for implementation leading up to the effective date.

Taking a deep dive
After completing a high-level assessment, it’s time to get into the details by performing a thorough technical assessment of all revenue transactions. Our experience shows that implementation issues are often identified during this deep dive, so companies shouldn’t underestimate the importance of this effort – or the amount of work involved.

Companies will also need to consider whether the impact the standard will have on financial measures will have implications to other aspects of the business, such as bonus plans, debt covenants, or income taxes. Companies will want to form a cross-functional team consisting of individuals from business units, sales, legal, human resources, finance, tax, and IT to identify any ripple effects. Considering how existing contracts would be recorded under the new standard may result in companies rethinking business strategies, such as how they price their products or the structure of their compensation plans.
Charting a course for implementation

Identifying system, process, and control changes

The new standard could result in pervasive impacts to systems, processes, and controls. The entire revenue process, from contract initiation to cash collection, will need to be aligned with the new five-step revenue model. For example, the standard requires the use of more judgments and estimates. As a result, systems, processes, and controls for processes such as reviewing contracts, assessing contract modifications, and estimating variable consideration will need to be evaluated.

The new standard also requires a significant amount of new disclosures, including disaggregated revenue and backlog. The disclosure requirements will impact all companies, regardless of whether the revenue line is changing. Complying with them could also require changes to systems, processes, and controls in order to capture the necessary information.

Implementing the required changes

Once the necessary changes to systems, processes, and controls are identified, they need to be implemented. This could involve manual and automated processes, so involvement from IT and other departments will likely be important throughout the implementation.

Even relatively minor changes to systems could take a significant amount of time and effort. As such, a long lead time may be required.

Testing the changes prior to the go-live date

The last phase is to test that the controls are operating effectively. Companies will want to allow adequate time to remediate any deficiencies. This step is critical to avoid surprises in the assessment of internal control over financial reporting in the year of adoption.

Implementation approach

<table>
<thead>
<tr>
<th>Current GAP</th>
<th>Complete accounting analysis</th>
<th>Identify system, process, and control changes</th>
<th>Implement system, process, and control changes</th>
<th>Test controls</th>
<th>New GAP</th>
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<tbody>
<tr>
<td>1/1/16</td>
<td>Possible dual reporting</td>
<td>1/1/16 Effective Date</td>
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Conclusion

The 2015 PwC - Financial Executives Research Foundation Revenue Recognition survey indicated that 75% of respondents have not yet completed their initial impact assessment, and of those, just over a third have not begun the assessment.

For many companies, adoption of the new standard will be a significant, multi-year undertaking. And, if the accounting assessment takes longer than planned, the time allotted to identifying and implementing the required changes may get compressed.

Companies should engage with their advisors, auditors and industry groups as necessary to ensure issues are discussed and resolved in a timely manner. In addition, management will need to develop a communication plan to explain the impact of the standard on the company’s financial results to stakeholders.

Companies need time to properly plan and prepare for the changes. Depending on the company’s circumstances, this time might be measured in years, rather than months, so it is imperative companies plan appropriately.
Questions and answers

Q: Why is it important to start the accounting analysis now?

A: The accounting analysis is critical for a company to understand the information that will need to be captured and reported. Once the analysis is completed, a company can identify and implement the necessary changes to systems, processes, and controls. The accounting analysis will also identify implementation issues that would apply to all companies in a particular industry that may need to be discussed in broader industry forums. For implementation issues being discussed across multiple industries, companies will want to ensure their industry has a seat at the table to influence the discussion.

Q: What is an example of a significant issue that companies have identified as part of their deep dive?

A: One of the more significant changes is the requirement to estimate variable consideration. Variable consideration includes performance bonuses and contingent fees. Under current US GAAP, companies delayed revenue recognition for variable fees until they were received or earned. Under the new standard, companies will need to consider their experience with similar arrangements to estimate variable consideration. This revenue may need to be recognized earlier than today.

Q: Given the modified retrospective transition method sounds like less work, why would companies choose the full retrospective transition method?

A: The modified retrospective transition method may require less dual recordkeeping, but it results in less comparability. Given revenue is a key performance indicator, many users will prefer the full retrospective transition method.

Companies will need to consider this factor along with other factors, such as resource availability, to manage the transition. Companies may also want to consider what competitors may be doing.

Q: Will the FASB delay the effective date of the standard again given some of the amendments are not yet final?

A: We believe it is highly unlikely that the FASB will further extend the deferral. The proposed changes to the new revenue standard are intended to clarify the guidance and ease transition (for example, through the addition of new practical expedients), as opposed to changing the core principles. Further, the FASB considered a two-year deferral when they decided on the one-year deferral. At that time, the FASB stated that it was unlikely to revisit that decision. The one-year deferral is also consistent with the decisions of the IASB on timing, and the FASB may desire to remain converged on the required effective date.

Q: What kind of disclosures will companies be expected to make before the effective date of the new revenue standard?

A: Public companies are required to disclose the anticipated impact of the revenue standard, if material. Such disclosures may be limited for 2015 filings. However, as companies progress through their implementation efforts and additional information becomes known, the disclosures should evolve and become more detailed.

Contact Information

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